

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN WATER)	
COMPANY TO INCREASE ITS RATES)	CASE NO. 95-554

O R D E R

The Commission has pending before it four issues on rehearing of the September 11, 1996 Order granting a rate increase to Kentucky-American Water Company ("Kentucky-American"). Rehearing was granted on four issues: 1) spousal travel; 2) cost recovery of the cost of service study; 3) cost recovery of the Automated Meter Reading Study ("AMR Study"); and 4) the effective date of the rate increase authorized by the September 11, 1996 Order. The first issue was raised by the Attorney General's Office of Rate Intervention ("AG"); the other three were raised by Kentucky-American. A hearing was held on April 30, 1997.

Spousal Travel. The Commission disallowed several miscellaneous expenses from forecasted operations based on the determination that these expenses were deemed inappropriate in prior cases and that Kentucky-American had failed to provide any new evidence warranting a change in the Commission's position. The AG argues that in Case No. 92-452, the Commission determined the cost of spousal travel was inappropriate and denied above-the-line treatment for the cost. Based on this past precedent, the AG requests that spousal travel of \$762 be eliminated from forecasted operations.

Given that in prior rate cases, the Commission has not recognized spousal travel in operating expense and the minimal amount in question, Kentucky-American did not contest the AG's position. Upon review of the record and given its past decisions on this issue, the Commission finds that the AG's uncontested adjustment is reasonable, and has therefore reduced forecasted operating expenses by \$762, an increase to net operating income of \$454.

Cost-of-Service Study. To recognize that the stockholders benefited from the billing and tariff group ("BAT Group"), the Commission excluded the associated cost from rate base. However, Kentucky-American asserts that by removing the unamortized BAT Group costs from rate base, the Commission inadvertently removed the costs associated with the cost-of-service study. Kentucky-American pointed to the Commission's past practice of allowing the unamortized cost-of-service study expenses in rate base, in requesting that rate base be increased by \$22,364, to reflect the unamortized cost of its cost of service study net of deferred income taxes.

Kentucky-American's Workpaper W/P-1-12, Calculation of Average Rate Base Elements Deferred Debits, did not separately identify the costs of the BAT Group from the cost-of -service study. Because of this, the Commission was not aware that the BAT Group and cost-of-service study costs had been combined. Furthermore, Kentucky-American is correct that in its past rate case proceedings, the Commission has recognized that a cost-of-service study does not directly benefit the shareholders and has therefore included the unamortized cost in rate base.

Kentucky-American has demonstrated that the cost-of-service study was included in the BAT Group costs. Based on the Commission's past practice of recognizing the cost-of-service study in rate base, it is appropriate to include these costs in rate base. Therefore, the Commission finds that rate base should be increased by \$22,364,¹ and deferred income tax expense increased by \$6,048.² The increase to deferred income tax expense results in a dollar-for-dollar decrease to net operating income.

AMR Study Costs. The Commission removed the unamortized cost of the AMR Study from rate base because Kentucky-American's ratepayers are not currently receiving a benefit from the AMR Study and the AMR program may never be implemented.

Kentucky-American pointed to the Schumaker & Company management audit recommendation that, "a comprehensive study be conducted to determine the applicability of AMR." This recommendation led Kentucky-American to perform the AMR Study to identify the costs and benefits of the AMR program. Its study concluded that the AMR costs currently outweigh the benefits, resulting in a delay in the implementation of the AMR program, which Kentucky-American claims benefitted its ratepayers. The Commission's past practice of recognizing in rate base the unamortized costs of projects incurred to benefit the ratepayers was another reason cited by Kentucky-American. For

¹	Unamortized Cost of Service Study Expenses	\$ 37,500
	Less: Unamortized Deferred Income Taxes	- 15,136
	Net Cost of Service Study Expenses	<u>\$ 22,364</u>
²	State Deferred Income Tax Expense	\$ 1,236
	Federal Deferred Income Tax Expense	+ 4,812
	Deferred Income Tax Expense	<u>\$ 6,048</u>

these reasons, Kentucky-American requested rate base be increased by \$65,583 to reflect the unamortized AMR Study costs net of the deferred income taxes.

In this instance Kentucky-American performed the AMR Study in response to a recommendation made in a Commission mandated management audit. Kentucky-American provided sufficient evidence to show that its AMR Study benefited its rate-payers by postponing a capital project that is not currently cost beneficial. Furthermore, the periodical AMR Study review is verification of Kentucky-American's intent to implement the AMR program as soon as the benefits outweigh the costs. Thus, there is no doubt that the AMR program will be implemented at some time in the future.

For these reasons the Commission finds that the unamortized AMR Study costs should be included in rate base, which results in an increase to rate base of \$65,583³ and an increase to deferred income tax expense of \$9,864.⁴ The increase to deferred income tax expense results in a dollar-for-dollar decrease to net operating income.

Effective Date of New Rates

The increased rates proposed by Kentucky-American were suspended for six months by the Commission, pursuant to KRS 278.190(2), to become effective on August 29, 1996. When the Commission was unable to complete its investigation by that date, Kentucky-American filed a notice of intent to place its proposed rates into effect on August

³	Unamortized AMR Study Costs	\$ 109,969
	Less: Unamortized Deferred Income Taxes	- 44,386
	Net Cost of Service Study Expenses	<u>\$ 65,583</u>
⁴	State Deferred Income Tax Expense	\$ 2,016
	Federal Deferred Income Tax Expense	+ 7,848
	Deferred Income Tax Expense	<u>\$ 9,864</u>

29, 1996. The Commission by Order dated August 30, 1996, directed Kentucky-American to keep its records in such manner to allow determination of the amounts to be refunded and to whom due, in the event a refund is ordered.

On September 11, 1996, the Commission issued its Order approving new rates that were lower than those proposed by Kentucky-American, and directing that the new rates be effective August 29, 1996 if Kentucky-American had actually billed its proposed rates or September 11, 1996 if the proposed rates had not been billed.

Kentucky-American argues that while KRS 278.190(2) authorizes a utility to place its proposed rates in effect at the expiration of the suspension period, there is no requirement that the proposed rates actually be used for billing purposes. Kentucky-American cites KRS 278.225, which provides that a utility has two years to bill for service rendered, for the proposition that billing under its proposed rates is not a prerequisite to making such rates effective. In addition, Kentucky-American explained that due to computer limitations during this time frame, it lacked the capability to maintain its records in the form required by the Commission if the proposed rates were actually used for billing purposes.

The AG asserts that Kentucky-American's decision to delay for 13 days issuing bills that would otherwise have been issued during that period negates Kentucky-American's intent to place the proposed rates in effect. Under these circumstances, the AG claims that the new rates approved by the Commission should be effective September 11, 1996, not August 29, 1996.

The Commission finds that this is an issue of first impression. The Commission has traditionally viewed KRS 278.190(2) to require a utility to regularly issue bills using its

proposed rates after it gives the requisite notice to place its proposed rates in effect. However, it appears that this view has not previously been expressed in any Order. In addition, there have been prior occasions when Kentucky-American has given notice under KRS 278.190(2) and deferred billings, as it did here, and the Commission authorized the new rates to be effective at the expiration of the suspension period.

The Commission's prior actions may have led Kentucky-American and other utilities to believe that they can place their proposed rates in effect but then defer regular billings to avoid the need to make refunds. Consequently, we will limit the interpretation herein of KRS 278.190(2) to be prospective only. Since in this case Kentucky-American's billing deferrals after the expiration of the suspension period were in conformity with its prior practices and necessitated by its computer limitations, the rates in the September 11, 1996 Order should have been effective for service rendered on and after August 29, 1996, the date the proposed rates were made effective. In all future cases, new rates approved after the expiration of the suspension period will be effective as of the end of the suspension period only when the utility gives the statutory notice and does not defer its regularly scheduled billings.

Making the new rates approved on September 11, 1996 effective for service rendered on and after August 29, 1996 results in a one time revenue increase of \$53,958. Kentucky-American has proposed that this increase be collected by a one-time surcharge calculated as an equal charge per customer. Considering the non-recurring nature of this increase and the amount of revenue to be collected, the Commission finds that a one-time surcharge per customer is reasonable. Kentucky-American should file

a proposed tariff with supporting schedules showing the derivation of the surcharge amount and the time it will be effective.

CONCLUSION

In its September 11, 1996 Order, the Commission determined that Kentucky-American's interest synchronization expense was \$5,188,675 based on the rate base and weighted cost of debt found reasonable in that Order. Based on the increases to rate base found reasonable herein, this expense should be reduced by \$3,931, which results in an increase to net operating income of \$1,587.

Based on the findings made herein, Kentucky-American has an increased annual revenue requirement of \$37,165, which was calculated in the following manner:

Net Rate Base Increase	\$ 87,947
Multiplied by: Overall Rate of Return	<u>x 9.32%</u>
Return on Rate Base Adjustments	\$ 8,197
Add: Net Operating Income Decrease	<u>+ 13,871</u>
Revenue Deficiency	\$ 22,068
Multiplied by: Gross-up Factor	<u>x 1.6840999</u>
Revenue Increase	<u>\$ 37,165</u>

The rates set forth in Appendix A are designed to produce additional annual revenues of \$37,165 and are fair, just and reasonable rates to be charged by Kentucky-American for service rendered on and after the date of this Order.

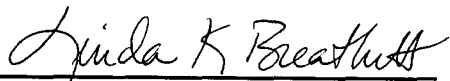
IT IS THEREFORE ORDERED that:

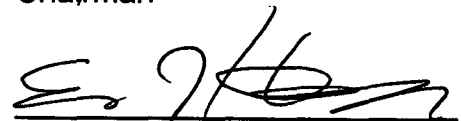
1. The rates set forth in Appendix A are approved for service rendered on and after the date of this Order.
2. Kentucky-American is authorized to collect \$53,958 by a one-time surcharge calculated as an equal charge per customer.

3. Within 30 days from the date of this Order, Kentucky-American shall file revised tariffs reflecting the rates set forth in Appendix A and the surcharge approved herein.

Done at Frankfort, Kentucky, this 29th day of September, 1997.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 95-554 DATED SEPTEMBER 29, 1997

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

SERVICE CLASSIFICATION NO. 1

Meter Rates

The following shall be the rates for consumption, in addition to the service charges provided herein.

<u>Customer Category</u>	<u>Rate Per 1,000 Gallons All Consumption</u>	<u>Rate Per 100 Cubic Feet All Consumption</u>
Residential	\$2.01245	\$1.50934
Commercial	1.89912	1.42434
Industrial	1.52096	1.14072
Municipal and Other		
Public Authority	1.81925	1.36444
Sales for Resale	1.74044	1.30533

Service Charges

All metered general water service customers shall pay a service charge based on the size of meter installed. The service charge will not entitle the customer to any water.

<u>Size of Meter</u>	<u>Service Charge</u>	
	<u>Per Month</u>	<u>Per Quarter</u>
5/8 Inch	\$ 6.64	\$ 19.92
3/4 Inch	9.96	29.88
1 Inch	16.60	49.80
1-1/2 Inch	33.20	99.60
2 Inch	53.12	159.36
3 Inch	99.60	298.80
4 Inch	166.00	498.00
6 Inch	332.00	996.00
8 Inch	531.20	1593.60

SERVICE CLASSIFICATION NO. 3

AVAILABILITY OF SERVICE

Available for municipal or private fire connections used exclusively for fire protection purposes.

Fire Service Rates

<u>Size of Service</u>	<u>Rate Per Month</u>	<u>Rate Per Annum</u>
2 Inch Diameter	\$ 3.88	\$ 46.56
4 Inch Diameter	15.52	186.24
6 Inch Diameter	34.88	418.56
8 Inch Diameter	62.00	744.00
10 Inch Diameter	96.88	1162.56
12 Inch Diameter	139.52	1674.24
14 Inch Diameter	189.93	2279.16
16 Inch Diameter	248.01	2976.12

SERVICE CLASSIFICATION NO. 4

Rates for Public Fire Service

	<u>Rate Per Month</u>	<u>Rate Per Annum</u>
For each public fire hydrant contracted for or ordered by urban county, county, state, or federal government agencies or institutions	\$23.24	\$278.88

Rates for Private Fire Service

	<u>Rate Per Month</u>	<u>Rate Per Annum</u>
For each private fire hydrant contracted for by industries or private institutions	\$34.88	\$418.56

HIDDEN LEAK ADJUSTMENT: A charge of twenty-five percent (25%) of the applicable tarified rate will be applied to all water usage determined to be the result of a hidden underground leak.